Statement of
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and Community Opportunity
House of Representatives

Concerning the Federal Housing Administration's
Title I Property Improvement Loan Program

Chairman Lazio and Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss current issues related to HUD's Title I Property Improvement Loan Program. This program is one of the oldest programs in the Department. When originally passed by the Congress in 1934, this program was intended to combat the widespread unemployment of the depression period and help improve neglected properties. Since then, the program has been expanded to include the rehabilitation and restoration of existing structures, the repair and replacement of improvements that have been destroyed or damaged and the repair and purchase of manufactured homes and home lots. There are no specific income requirement for persons using the program. It is expected that the borrower is creditworthy and able to meet any down payment requirements.

It's been more than 12 years since the Office of Audit did our most comprehensive examination of the Title I Property Improvement program. Just as you have seen in the Philadelphia Inquirers series of articles, we found a high percentage of unscrupulous dealers and contractors taking advantage of borrowers. A large percentage of dealers overcharged for work and much of the work was considered shoddy and cheap.

We made the bold recommendation at that time to eliminate the dealer portion of the program. The Department disagreed with our recommendation and after considerable discussions, the Department promised to make certain improvements to the program that would minimize such abuses in the future. The Title 1 Program is a very small part of HUD's business line. The program staff assigned has been cut dramatically under the HUD 2020 Management Reform Plan. Five years ago the Title 1 Program was staffed with 188 persons. Under the reorganization, nearly all responsibilities for the program have been transferred to the Albany Service Center. There is a small cadre of Headquarters staff (about 4) to handle policy matters. The Albany Center is staffed with approximately 50 persons. The center has total responsibility for asset recovery, claims, collecting premiums and liaison with the Department of Treasury for debt collection. Lender monitoring of Title I activity will be handled through the Quality Assurance staff at each of the four Homeownership Centers. This monitoring has been a low priority in the past and will likely become a lower priority in the future with reduced staff.

We conducted a Survey of the Title I Home Improvement Program last fall. The survey was intended to look at the many program problems that have come up over recent months and decide what additional audit coverage was needed. The survey work was done by our Chicago Office and Dale Chouteau, our District Inspector General for Audit of the Midwest District is with me today.

Over the past ten years the Department has insured about $8 billion in home improvement loans. The average loan being slightly over $10,000. As of May 7, 1997, HUD paid claims totaling about $310 million or 3.9 percent of the total dollars insured. According to a draft market report prepared for HUD by Price Waterhouse, home improvement expenditures in 1996, totaled $117 billion, about 35 to 40 percent of that amount is financed through a variety of sources. Accordingly, Title I loan originations only represent about 3.1 to 3.6 percent of the home improvement work which was financed.

The dealer loan program has traditionally experienced higher claim rates, and still greater Program abuse than the direct loan program. Since the issuance of the Office of Inspector General report in 1986, the Department has made numerous changes to the Program. However, the Dealer loan program continues to experience much heavier claim rates than the Direct loan program and complaints of abuse. Over the past 10 years Dealer loans represented 42 percent of the loan volume, but 55 percent of the claims paid with claim rates of 4.9 percent as compared to 2.9 percent for the Direct loan program. Because of the Dealer loan abuses and excessive claims, on May 29, 1997, HUD issued a proposal for the elimination of the Dealer loan portion of the Title I Program. However, the program has yet to be eliminated and is still operation today.

HUD's oversight of the Title I Home Improvement Program is minimal; it is focused on claim payments; little focus is placed on identifying or preventing Program abuses by lenders or contractors. The Department has no system to track violations or otherwise determine if a pattern exists. Also, HUD's systems do not provide specifics as to who the program serves. Only through industry interviews and reviews of Mortgage Disclosure Information (HMDA) can HUD get any idea as to who the Title I program serves. HMDA data for 1995 would suggest the Title I program serves more than low and moderate income borrowers. Only about 28 percent of the borrowers were at the low and moderate income level.

The Office of Lender Activities, Quality Assurance Division does monitor lenders origination practices. This is not a high priority because this same office is responsible for monitoring Title II lenders that insure about $240 billion annually, as compared to $1.5 billion annually for Title I. During 1996 and 1997 only 10 reviews of 4,000 lenders participating in Title I were performed. It is true that referrals to the Department's Mortgagee Review Board has resulted in sanctions against lenders but the bulk of the cases involve false advertising practices rather than problems with contractor performance. Not until January 1997, did the Quality Assurance Division keep an active record of Title I dealers/contractors that were debarred or denied participation as a result of their reviews. During the approximate 10 months records were kept, 15 dealers were debarred; 22 companies were denied participation on a limited basis and 12 dealers/contractors received civil monetary penalties for work in the Title I program.

Because of the problems in the Title I Program, HUD contracted with Price Waterhouse to review several aspects of the Title I home improvement program. The studies included: (1) the actuarial soundness and premium sufficiency of the program; and (2) market conditions affecting the Title I Program's viability. The market analysis involved interviews with lenders and purchasers of Title I and conventional loans and a survey of market practices.

Among the most significant findings in the Report were:

- The Program has been plagued by abusive practices in the dealer program and high losses in the direct lending program, especially in California.
- Poor credit practices throughout the consumer credit market have had a contagious effect on Title I. HUD has not adapted to these market changes and Title I is subject to adverse selection of lower quality borrowers.
- The Title I insurance premium that HUD charges is insufficient to cover the risks of the Program.
- The current premium structure is outmoded. The effective life of Title I loans is shortening as better quality borrowers prepay their loans. The prepayments exacerbate the adverse selection problem and prevent HUD from collecting sufficient premium income.
- Many industry participants suggest that FHA increase its monitoring and enforcement activities. However, because HUD is downsizing, and has limited resources it may prefer to use market mechanisms and information technology as enforcement structures.

The report outlines a range of restructuring options to reducing the program's unacceptable characteristics or have the most support among participants in the Title I market. The options include:

- Eliminate the Title I program. This option was not supported by the market participants.
- Reduce the scope of the current program by eliminating dealer loans, and/or further restricting the use of loan proceeds. This option received mixed opinions from market participants. Further restricting the use of loan proceeds may be difficult because of difficulties in clearly defining what is acceptable.
- Expand the program to make it more competitive with new market products by raising the loan limit and liberalizing the use of loan proceeds. Price Waterhouse noted that there is no compelling reason to increase the loan limits and liberalizing the use of loan proceeds would appear to

violate the legislative intent of the program and be outside of HUD’s mission.

- Manage the risk of the Title I program including components to: charge actuarially sound insurance premiums; restructure the payment of insurance premiums; improve the requirements for the program’s loan and borrower characteristics; impose tighter requirements on loan correspondents and dealers; and improve HUD’s information systems for lender monitoring, portfolio monitoring, claims processing, risk management, and quality control.

- Instituting a combination of the above options to reduce risk and improve the soundness of the Title I program.

At the time of our review HUD had not yet decided which, if any of the options outlined by Price Waterhouse it intends to implement.

Because of the pending Departmental proposal to eliminate the Dealer portion of the Program, and the recent study of the program conducted by Price Waterhouse, we concluded a nationwide review was not warranted at this time. However, we identified some lenders whose loan origination activity and claim rates indicated possible abuse. These lenders were referred to our District Inspectors General for potential audit.

Finally, we found no reason to alter our recommendation to eliminate the Program and included it in our most recent legislative proposals. The reason we believe that the program should be eliminated include that:

- The Program serves only a small percentage of the population about 3.1 to 3.6 percent of the home improvement work financed.

- One of the strongest arguments for retaining the Program, is that the Program provides access to low income populations which might not otherwise be able to obtain financing for home repairs or improvements. However, this conclusion is not based on documented evidence. As stated earlier, only 28 percent of the borrowers using the Program are low and moderate income. Low income populations have access to other HUD and State funded programs which can be used for home repair purposes. For example, HUD funded programs, such as the Community

Development Block Grant and HOME Programs; as well as some State programs financed with tax-exempt bonds, serve low income families.

- Because of the small size of the Title I Program in comparison to HUD's other mortgage insurance programs, the Title I Program has not been closely monitored. HUD's current downsizing does not provide much opportunity for increasing HUD's ability to monitor the Program more closely.
- The Program is not self-supporting. Annual claims are 3 to 4 times higher than annual insurance premiums collected. While the insurance premiums could be increased, doing so would make Title I loans more expensive for low income families.
- Given HUD's downsizing its would be difficult for HUD to restructure the Title I Program and improve its information systems in an effective and efficient way. Tightening of borrower credit requirements, or restrictions on the use of loan proceeds would likely reduce the Program's use further.

In conclusion, at the very least, the Dealer loan program should be eliminated. In response to HUD proposed rule to eliminate the dealer loan program, HUD received over 200 responses. Most of the respondents were in favor of strengthening controls over the program. However, as mentioned earlier there are very few staff that could carry out this function. While elimination of the dealer portion of the program would not prevent current property improvement dealers from providing their services under the Title I program, it would require them to have direct lender oversight and monitoring which would be a more practical method of keeping the Title I program in existence.